EX PARTE OR LATE FILED

EX PARTE OR LATE FILED

DOCKET FILE COPY ORIGINAL

RECEIVED

SEP 19 1995

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

COVINGTON & BURLING
1201 PENNSYLVANIA AVENUE, N.W.
P.O. BOX 7566
WASHINGTON, D.C. 20044-7566
(202) 662-6000

TELEFAX: (202) 662-6291
TELEX: 89-593 (COVLING WSH)
CABLE: COVLING

WRITER'S DIRECT DIAL NUMBER

LECONFIELD HOUSE
CURZON STREET
LONDON W1Y 8AS
ENGLAND
TELEPHONE: 44-171-495-5655
TELEFAX: 44-171-495-3101

BRUSSELS CORRESPONDENT OFFICE
44 AVENUE DES ARTS
BRUSSELS 1040 BELGIUM
TELEPHONE: 32-2-512-9890
TELEFAX: 32-2-502-1598

GERARD J. WALDRON*
(202) 662-5360

* MEMBER OF THE BAR OF PENNSYLVANIA
NOT ADMITTED IN THE DISTRICT OF COLUMBIA

September 19, 1995

BY HAND

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, D.C. 20554

Re: Ex Parte Presentation in MM Docket No. 95-90

Dear Mr. Caton:

On September 11, 1995, the following material was submitted to Bruce McCullough in the Mass Media Bureau, and should be included in MM Docket No. 95-90.

Pursuant to section 1.1206 of the Commission's rules, this original and one copy have been submitted to the Secretary, and a copy supplied to each staff person. If there are any questions on this matter, please contact the undersigned.

Sincerely,

Gerard J Waldron

Gerard J. Waldron, Esq.*

Enclosure

cc: Mr. Bruce McCullough (w/encl.)

No. of Copies rec'd 0+1
List ABCDE

EX PARTE OR LATE FILED

RECEIVED

SEP 1 9 1995

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Bruce,

This is all rather old. See (1) the cites on 4-7 (ft.13), and (2) the price correlations on pp. 4-13 on. For a more rigorous test, see also (3) the attached correlations of first differences (annual CPM growth rates) for 1970-83. None is saying that network and spot are perfect substitutes, just that they are the closest, and are close enough to affect each other. Clearly, one could update all this, and someone probably would have (or could) if there were any serious dispute on the issue. Of course, if you looked at price correlations, you'd have Greg Werden to deal with, but that's life.

This is a quick look through the earlier stuff. If there is something new, it's probably in the J of Media Economics somewhere.

Good luck. Let me know if there is anything else I can do that I can without filing something new.

Rick

(3)

TABLE 2-2

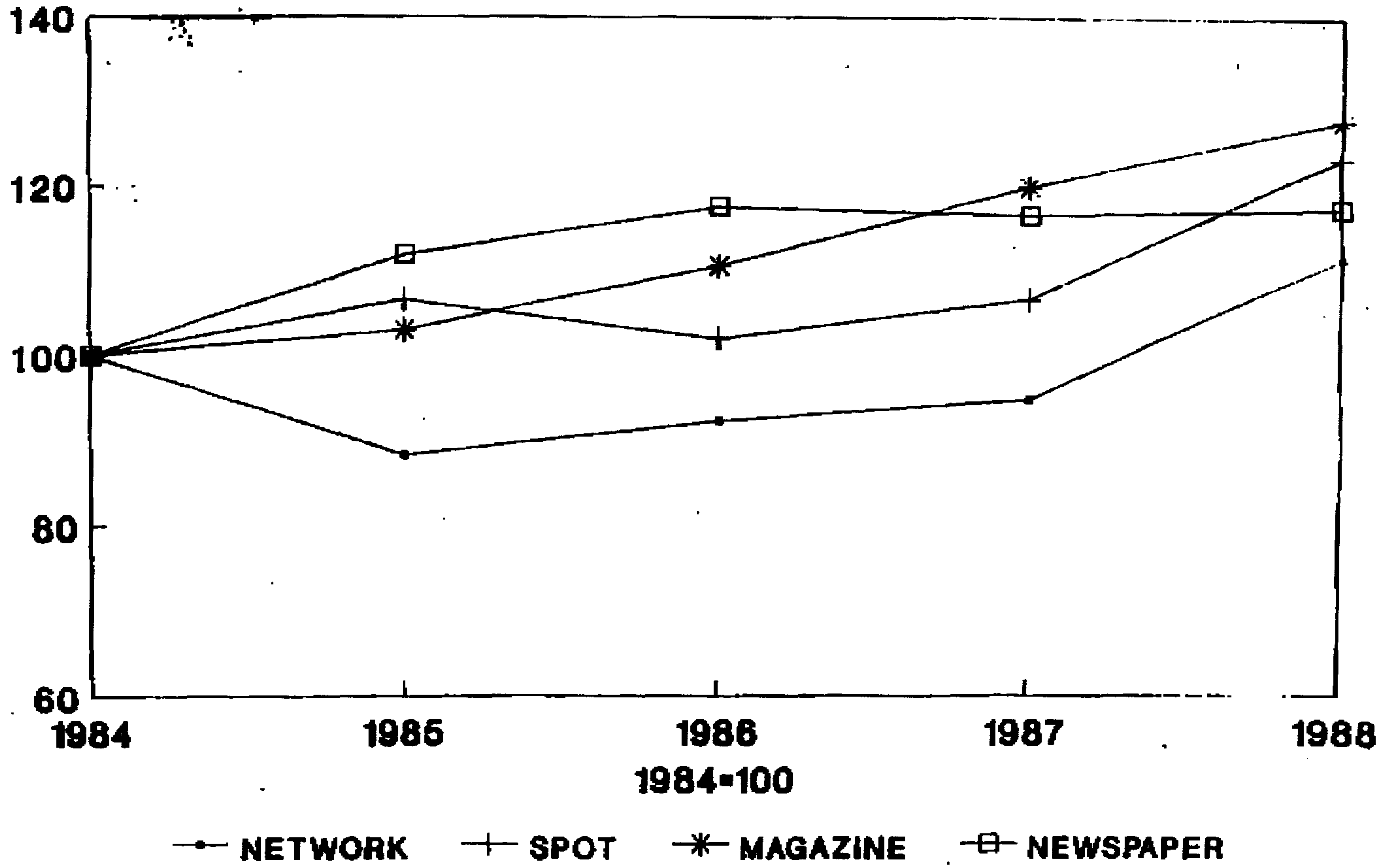
Price Correlations on Annual CPM Growth Rates of Advertising Media

1970 - 1983

Media	Correlation Coefficient
Nighttime Spot and Network TV	0.52
Magazines and Network TV	0.40
Newspapers and Network TV	0.12

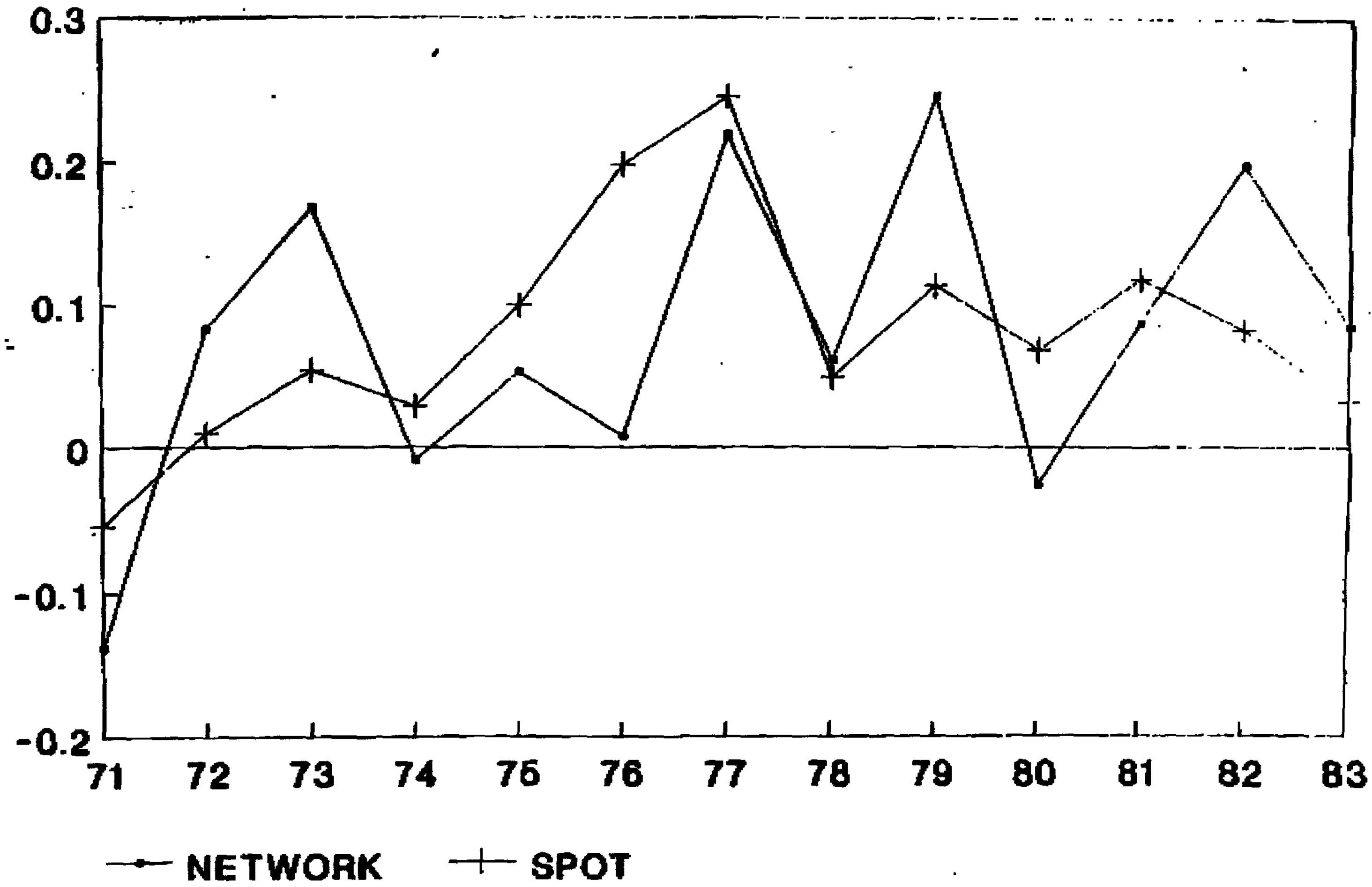
Source: Television Bureau of Advertising, "Trends in Media," July 1987

FIGURE 2-2
INDICES OF SELECTED MEDIA CPM'S
1984-88



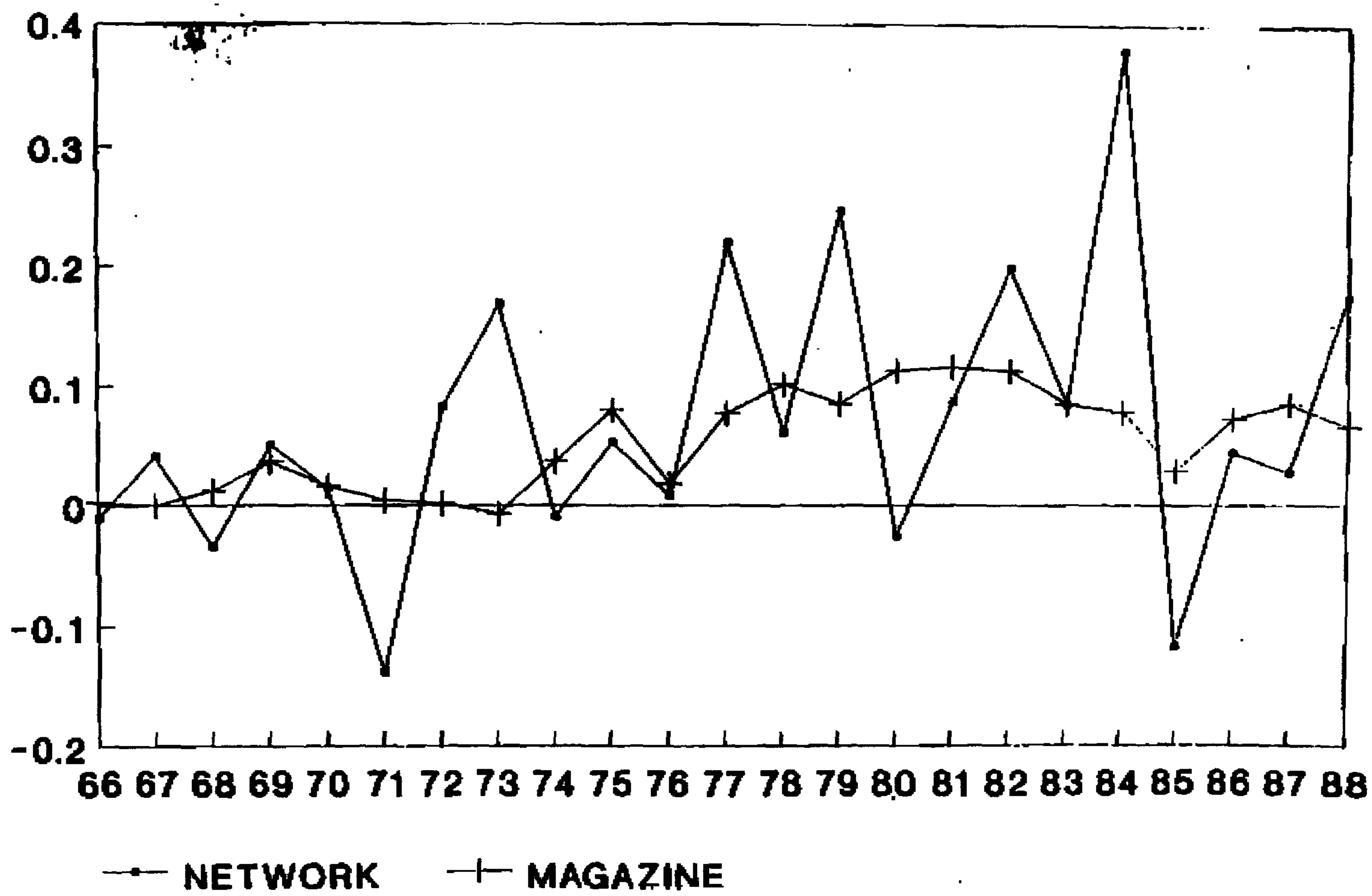
Source: See Figure 1

FIGURE 2-3
ANNUAL CPM GROWTH RATES FOR NIGHTTIME SPOT AND NETWORK TV ADVERTISING 1971-83



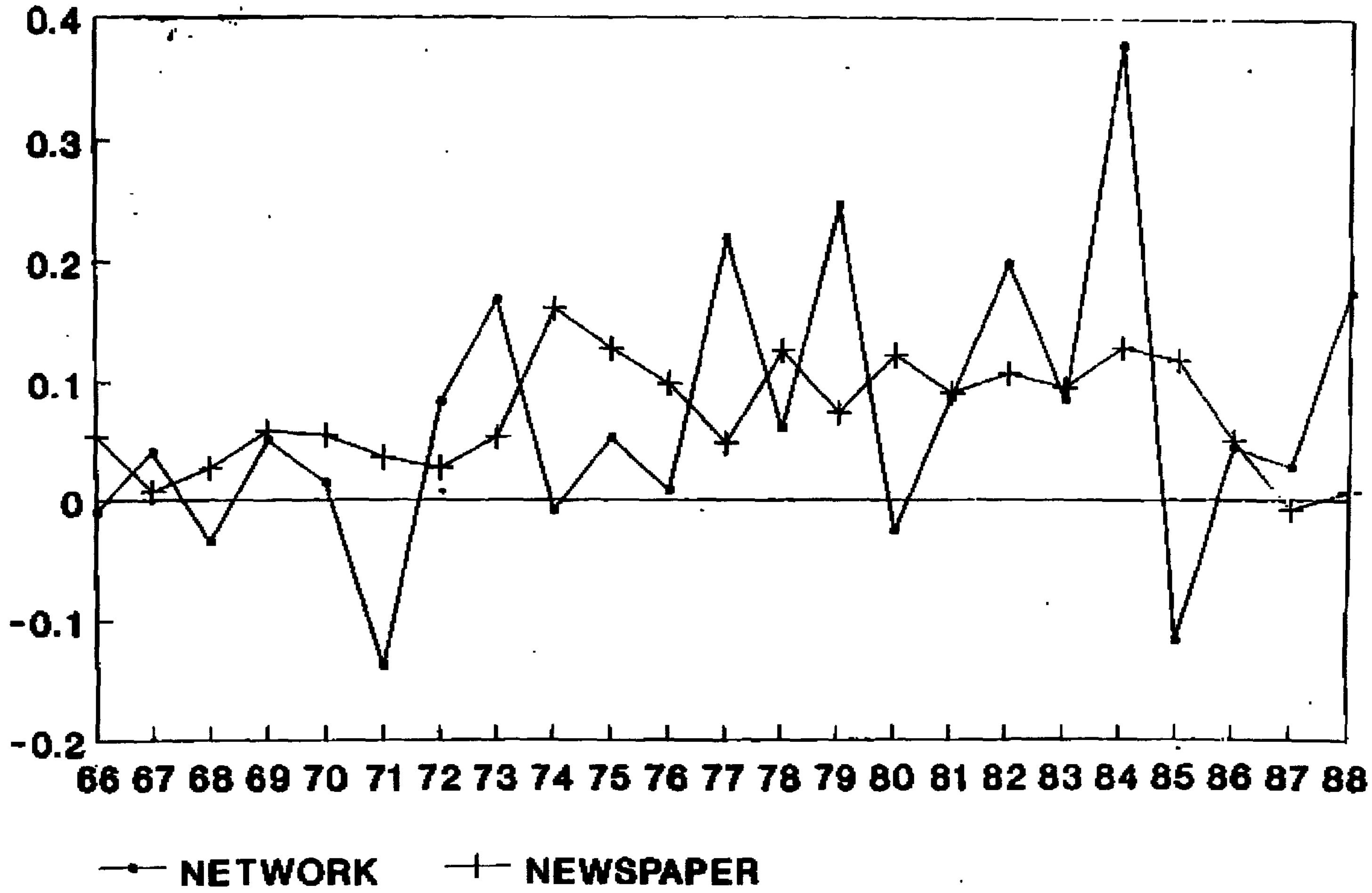
Source: See Figure 1

FIGURE 2-4
ANNUAL CPM GROWTH RATES FOR MAGAZINE AND NIGHTTIME TV NETWORK ADVERTISING 1966-88



Source. See Figure 1

FIGURE 2-5
ANNUAL CPM GROWTH RATES: NEWSPAPER AND NIGHTTIME TV NETWORK ADVERTISING 1966-88



Source: See Figure 1

ANALYSIS OF THE IMPACTS OF REPEAL OF THE FINANCIAL INTEREST AND SYNDICATION RULE

Prepared for:

THE COMMITTEE FOR PRUDENT DEREGULATION

ICF INCORPORATED

indeed an economic market. Further, this market is currently concentrated. This implies that market power can be exercised.[12]

The outline of this section is as follows. First, a priori arguments raised by others to the effect that television advertising is not a market are considered. Second, the evidence that television advertising is a market is considered. This evidence consists of an overview of the characteristics of television advertising, an examination of historical price trends among the various significant advertising media, a preliminary examination of some spot advertising price data, and the views of various industry participants. Finally, the position of the networks in the market is assessed.

1. Previous analyses

Some observers have concluded that all of the various media compete with one another for advertising dollars. That is, television, radio, newspapers, magazines, direct mail, billboards, etc. are all in the same market.[13]

Moreover, the Commission and some academic studies have previously concluded that there is sufficient cross-elasticity of demand between television and newspaper advertising to raise concerns about the cross-ownership of television stations and newspapers in local markets.[14]

These previous analyses raise two questions. First, does the presence of substitutes for television advertising imply that a sole supplier would not be able to raise and maintain prices? Second, if television advertising is a

---

[12]As discussed in Section A, if television advertising is a market, integrated firms may have the incentive to restrict the supply of off-network programs in order to increase advertising rates. However, even if television advertising is not a market, the analysis in Section A above showed that an integrated supplier of off-network programming may be able to increase total net advertising revenues by restricting the supply of off-network programming.

[13]See Network Inquiry Special Staff, "The Market for Television Advertising," preliminary report (June 1980). This report is discussed in Appendix 1-j. Also see Bruce M. Owen, Jack H. Beebe and Willard G. Manning, Television Economics Lexington, MA: D.C. Health and Company, (1974), pp.93-94. Owen, et. al. conclude that "there are relatively few products for which network television has a comparative advantage as an advertising vehicle, and there are a number of more or less good substitutes: spot television advertising, network and spot radio, national magazines, direct mail, billboards and newspapers," p. 93 (emphasis supplied, footnote omitted).

[14]See Second Report and Order in Docket No. 18110, 50 FFC 2d 1046 (1975) and James N. Rosse, Bruce M. Owen, and David L. Grey, "Economic Issues in the Joint Ownership of Newspaper and Television Media," FCC Docket 18110, May 1970.

separate market, can other advertising media nonetheless influence the price of television advertising?

We begin with the second question. The Commission decision in Docket 18110 was probably correct even if television and newspapers were in separate economic markets. Television advertising can constitute a separate economic market, yet common ownership of television stations and newspapers could reduce competition. That is, control by a single firm of two products that are in separate markets and are also partial substitutes can enhance market power. All goods that are substitutes for one another are not necessarily (indeed, are seldom) included in the same product market. A product market is defined to include the smallest number of substitute goods that a single firm would need to control in order profitably to raise and maintain price significantly above prevailing levels. If a single firm also controls the next closest substitutes, it will raise price still further above cost.[15] Thus, if newspapers and television are in separate markets and also compete with one another, cross-ownership could lead to higher advertising rates.

An answer to the first question (i.e., whether television and other media are in the same advertising market) requires an examination of the available empirical evidence. Before turning to that examination, however, it will be useful to examine the a priori argument that all advertising media are in the same market because advertisers can and do use alternative media.

When advertising is viewed as an input to the production process, the fallacy of this argument becomes evident. A producer uses all inputs up to the point that the marginal value of additional use of each input equals its marginal cost. For example, labor and capital are both inputs into the production process. This does not mean that both types of inputs are in the same economic market or that a reduction in the supply of labor would not lead to an increase in wages. An increase in the price of capital would lead to some substitution among the inputs, but would certainly not lead to complete substitution.

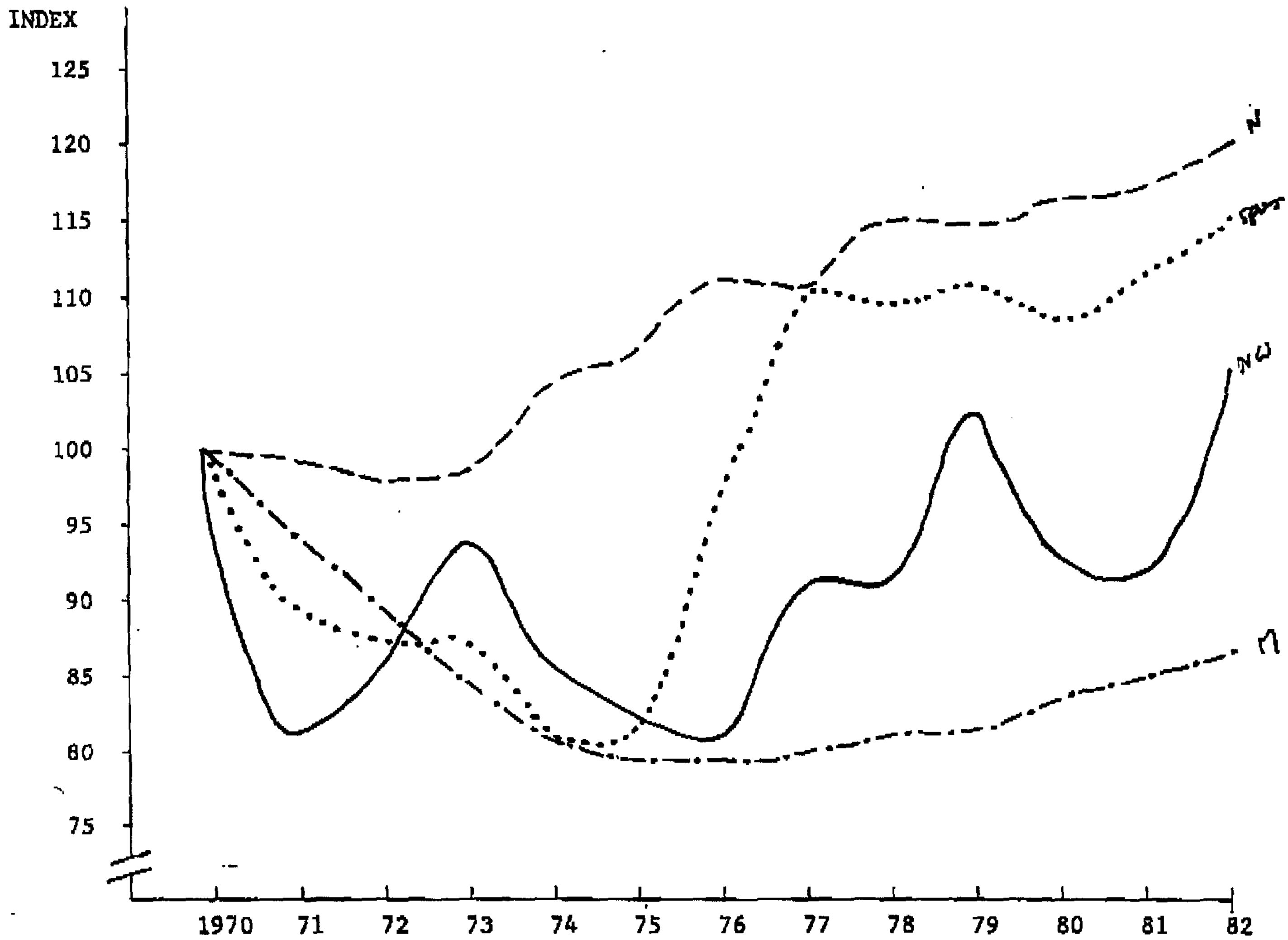
The various advertising media can each be viewed as separate inputs into the production process. They each differ from one another in significant ways including geographic reach, demographic characteristics, and impression on readers or viewers. A large advertiser will take advantage of these differences to optimize the media mix in his advertising program. Each medium will be used up to the point that an additional dollar of expenditure results in the same marginal return as the last dollar spent on other media. Higher television advertising rates will cause advertisers to substitute other media, and, depending on the substitutability of those other media, total television advertising revenues may rise or fall.

---

[15]See Gregory J. Werden, "Section 7 of the Clayton Act and the Analysis of 'Semihorizontal' Mergers," Antitrust Bulletin (Spring 1982), pp. 135-160.

EXHIBIT 2-12

TRENDS IN MEDIA ADVERTISING COSTS
INDEXED [1970=100] IN REAL DOLLARS[1]
1970-1982



Key:

- - - Cost per 1000 circulation for 1000 lines each daily for daily newspapers in the US, in real dollars and indexed.

..... Cost per 1000 homes for 30 seconds of spot television in top 100 markets for nighttime (M-S), real dollars and indexed.

——— Cost per 1000 homes for 30 seconds of network television for nighttime (M-S), real dollars and indexed.

-•-•- Cost per page per 1000 circulation for 4-color magazine advertising, based on rates of 50 leading magazines, real dollars and indexed.

---

[1] Implicit price deflator for GNP from Bureau of Economic Analysis' Survey of Current Business. 1982 deflator is average of first three quarters that BEA has reported to date.

Source: "Trends in Media" prepared by Research Department of Television Bureau of Advertising, September 1982.

EXHIBIT 2-11

MAJOR MEDIA COST TRENDS

Year	Network Television 1/ (Cost Per 1000 Viewers)	Spot Television 1/ (Cost Per 1000 Viewers)	Magazine (Cost Per Page Per Per 1000 readers)	Newspaper (Cost Per 1000 Lines Per 1000 Circulation)
1970	$2.10	$3.10	$5.98	$6.30
1971	1.81	2.93	6.02	6.53
1972	1.96	2.96	6.00	6.71
1973	2.29	3.12	5.93	7.07
1974	2.27	3.21	6.14	8.21
1975	2.39	3.53	6.62	9.26
1976	2.41	4.23	6.77	10.17
1977	2.94	5.27	7.36	10.66
1978	3.12	5.53	8.05	12.00
1979	3.89	6.16	8.70	12.89
1980	3.79	6.58	9.72	14.46
1981	4.12	7.36	10.83	15.77
1982	4.94	7.97	11.69	17.13

1/ Night-time.

Source: Data reported by Television Bureau of Advertising, "Trends in Media," September 1982. The network price data are from A. C. Nielsen, spot data are from the TVB Spot Television Planning Guide, magazine costs from the Magazine Publishers Association, and newspaper rates are from the Editor and Publisher's International Yearbook.

revenues earned by these media actually increased slightly from 31 percent in 1975 to an estimated 34 percent in 1981.[16]

Preliminary studies of spot television price data also provide some information that suggests that television is in a separate advertising market. Prices per thousand viewers in the top 50 television markets are negatively related to the market share of independent stations. If television advertising were a perfect substitute for other media, one would not expect that a change in the audience share of independent stations would substantially affect the advertising rate. (The possibility that network and spot television are in separate submarkets is discussed in the next section.) It is possible that increased independent audience share could in part reflect a larger total audience. This, by itself, would tend to reduce advertising rates. It is unlikely, however, that a large part of the correlation could be explained by this phenomenon. Another possibility is that independent stations achieve large market shares in large markets where there are many media alternatives. Competition from these other media alternatives, rather than a large independent share could, in principle, explain the observed correlation.[17]

The above analysis suggests that television advertising is a separate economic market. The most convincing piece of evidence, however, is the position that large national advertisers have taken in this proceeding through their national trade association.[18] The only reason the large, sophisticated members of the Association of National Advertisers could have to be concerned about repeal of the Rule is that television advertising is a market and that strong independent television stations contribute to holding prices down in this market. If these advertisers viewed other media as close

---

[16]Revenue data are from McCann-Erickson, Inc., reported by the Television Bureau of Advertising, "Advertising Volume in the United States," August 1982.

[17]Price data for November 1982 were obtained from Spot Quotations and Data (SQAD). These data, which are used by advertisers, advertising agencies and large advertisers, are supplied to SQAD by media buyers and reflect transactions prices. Independent station share was computed from Nielsen data for November 1982. In the Early Fringe and Early News periods, spot cost per thousand viewers and independent market share were negatively correlated (and significantly so). This result appears to conflict with the results of the Network Inquiry Special Staff preliminary report on "The Market for Television Advertising." The Network Inquiry staff, however, used number of stations instead of market share as a measure of independent station competitive impact. Moreover, Appendix 1-j below demonstrates that the Network Inquiry methodology is seriously flawed. See also the Justice Department comments on the Network Inquiry Report.

[18]See Address of Thomas J. Ryan before the Independent Television Association, Los Angeles, California, January 18, 1983.

substitutes for television advertising, they would not be especially concerned about higher rates for television. Our conclusion is that, although other media are certainly substitutes for television advertising, television advertising constitutes an economic market. Moreover, the three television networks have significant shares of this market. Therefore, they likely face downward sloping demand curves.

D. Network vs. National Spot Advertising

Section A described two alternative strategies that a sole integrated supplier of off-network programs could use to profitably raise television advertising rates above the competitive level. The supplier could raise the advertising rates its own stations charge and recapture the advertising revenues lost to competing independents by also raising the prices of off-network programs. Alternatively, the supplier could raise the price of off-network programs enough to reduce the advertising exposures supplied by independents, and this would increase the advertising revenues earned by its stations.

In Section B, it was explained that the networks could implement the first strategy by reducing either the amount of network advertising or the time available to O&Os and affiliates for spot advertising. However, if network and spot advertising are not substitutes, raising network advertising rates would not have the desired effect, because advertisers would not increase their demand for independents' time. Thus, the only way the networks could increase spot rates would be to reduce the advertising time available to O&Os and affiliates. (Affiliates would, of course, have to be compensated.) Unless the FCC would interfere with such behavior, this does not appear to create any serious obstacle to implementing the first strategy. Hence, the first strategy may not depend in any important respect on network and spot advertising being good substitutes.

There is at least one respect in which the profitability of the second strategy could be diminished if network and spot advertising were not substitutes. An increase in off-network program prices would then raise spot rates more than network rates. As a result, the gains to the networks from raising program prices would have to come largely from the increased revenues earned by O&Os and from any additional profits the networks could extract from their affiliates. Fewer of the gains could then be captured through higher network advertising rates.

In short, either the ability of the networks to raise advertising rates (under strategy one) or their ability to profit from higher advertising rates (under strategy two) clearly may depend on the extent to which network advertising competes with spot advertising. However, two products or services do not have to be in the same market in order to compete,[15] so that the networks could use either strategy to raise advertising rates even if network

[15]See footnote 15, supra.

and spot advertising are not in the same market. In what follows, we discuss the reasons why spot and network advertising may constitute separate markets, but conclude that they compete whether or not they are in the same market.

Network and spot advertising could constitute individual economic markets if a single supplier of each could raise prices. Single supply of both could result in even higher prices, in which case spot and network advertising would be separate submarkets of a larger television advertising market. (Television advertising, in turn, could be a submarket of a larger advertising market.). There are differences between the two modes of advertising that suggest the possibility of separate submarkets.

Network advertising can be viewed as a bundle of viewer exposures. The price of network advertising (per viewer exposure) tends to be lower than the price of spot advertising, suggesting that to sell the bundle of viewers the networks must provide a discount below spot prices. The transactions costs of purchasing spot advertisements to cover a large audience are high due to the need to deal with a large number of local outlets.[20] National advertisers who wish to reach the widest possible audience may not view spot advertising as a good substitute for network advertising at current prices. On the other hand, some large advertisers may want to reach buyers throughout much, but not all, of the country. (For example, there may be some regions, states, or localities where advertisers have no distribution outlets). Even in the face of different spot and network rates per viewer, these advertisers could view spot and network advertising as very close substitutes, since they might find the prices per <u>targeted</u> viewer to be quite similar.

All local and many regional advertisers clearly must regard network advertising as a poor substitute for spot advertising. These advertisers have little interest in paying for many viewers who, by virtue of their location, are not potential customers. Whether national and spot advertising are in the same market from the perspective of buyers thus depends on the relative number of national and regional advertisers who do regard them as close substitutes at current prices. If there are enough advertisers who would not switch between network and spot advertising in response to small changes in their relative prices, each are in the separate markets.

Two products that are not good substitutes can also be in the same market if both products are produced using the same inputs and suppliers can quickly switch from producing one product to the other.[21] There appears to be a

---

[20]Network advertising appears to provide national exposure at a lower cost per viewer, even if the higher transaction costs of spot television are ignored (see Exhibit 2-11). Spot rates per viewer ranged from 135 percent to 180 percent of network rates between 1970 and 1982.

[21]See the Department of Justice, "Merger Guidelines." Supply substitutability is the reason why, say, different shoe sizes or styles are typically placed in the same market when measuring a shoe producer's market share.

high degree of supply substitutability between network and spot advertising.[22] As a result, even if advertisers do not regard spot and network advertising as good substitutes, both may belong in the same market.

We have insufficient information to determine whether advertisers view network and spot advertising as close enough substitutes to place them in the same market. Interviews with some large buyers indicate, however, that many national advertisers view spot advertising as a substitute for network advertising. Substitutability is also evidenced by the price data plotted in Exhibit 2-12, which indicate that spot and network price changes tend to track each other somewhat.

If spot and network advertising compete, even though they are not in the same market, both strategies for raising advertising rates remain viable. Strategy one depends on the ability of the networks to drive up spot rates by reducing the spot advertising time available to network affiliates and O&Os. If the FCC were to block this route, a large enough reduction in the supply of network advertising would increase spot rates.

Strategy two depends on the ability of the networks to benefit from higher advertising rates. This in turn depends on the extent to which network rates rise in response to spot rates and the extent to which networks can extract profits from their affiliates.

---

[22]There are few, if any, technical constraints on the ability of networks to reduce, almost overnight, the amount of advertising time they sell and increase the amount of advertising time available for spot sale by O&Os and affiliates.